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Supreme Court of the United States,

OCTOBER TERM, 1925.

No. 336.

LAKE SUPERIOR CONSOLIDATED IRON MINES, OLIVER IRON MINING COMPANY, NORTHERN DEVELOPMENT COMPANY, *et al.*,
Appellants,

vs.

SAMUEL LORD, J. G. ARMSON, AND ODIN HALDEN, CONSTITUTING THE MINNESOTA TAX COMMISSION, *et al.*, ETC.,
Respondents.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MINNESOTA.

BRIEF FOR APPELLANTS.

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BRIEF FOR APPELLANTS.

I.

Jurisdiction of the Court.

This is an appeal from a decree of the United States District Court for the District of Minnesota. The decree was entered January 15, 1925, and may be found at page 31 of the printed Record. The opinion of the lower court has not yet been published, but may be found on page 23 of the Record.

The decree dismissed a bill of complaint filed by appellants seeking to restrain the enforcement of the so-called iron ore royalty tax, being Chapter 226 of the Laws of Minnesota, for the year 1923, on the ground that the imposition of the tax violated the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of the State of Minnesota. It was conceded at the trial by counsel for the defendants that the

Court had equity jurisdiction (p. 22). Decrees were entered by the lower court dismissing the bills of complaint in this and the other suits on the ground that the statute was constitutional.

The jurisdiction of this Court is invoked under Section 238 of the Judicial Code, as involving the construction or application of the Constitution of the United States, and as a case in which the Constitution or law of a state is claimed to be in contravention of the Constitution of the United States. We believe the jurisdiction of the Court is sustained by the decision in *Oliver Iron Mining Company* v. *Lord*, 262 U. S. 172.

Although the jurisdiction of the District Court was based upon the question arising under the Federal Constitution, the court had jurisdiction to consider not only the question under the Federal Constitution, but all other questions properly presented by the Record, including the validity of the tax under the Constitution of the State of Minnesota.

Chicago Great Western Ry. Co. v. *Kendall*, 266 U. S. 94;
Greene v. *Louisville & I. R. Co.*, 244 U. S. 499;
Ohio Tax Cases, 232 U. S. 576.

II.

Statement of the Case.

The appellants, being the plaintiffs in the court below, are certain corporations that during the year 1923 derived income in the form of royalties from leases, sub-leases, and assignments of certain fee, leasehold and contract interests owned and held by them. Plaintiff Lake Superior Consolidated Iron Mines is a New Jersey corporation and plaintiff Northern Development Company is a West Virginia corporation. The other plaintiffs are Minnesota corporations. Each has been a corporation of the same state for more than thirteen years (Record, p. 1).

The facts in the case are not in dispute. They are embraced in (*a*) substantial portions of the amended bill of complaint expressly admitted in the answer (Record, pp. 1-10), (*b*) an agreed statement of facts (Record, pp. 15-18), (*c*) Evidence taken in court (Transcript of Evidence, Record, p. 18), and (*d*) a stipulation *re* facts (Record, p. 22).

The text of the Royalty Tax Statute is contained in Appendix A of this brief, and also as an appendix of the bill of complaint, on page 8 of the printed Record. Briefly stated, the statute imposes a tax of 6% upon "all royalty received * * * during the calendar year * * * for permission to explore, mine, take out and remove ore from land in this State." The statute requires persons to whom such royalty is paid to make certain reports to the Minnesota Tax Commission; provides for assessment of the tax, with severe penalties for non-payment; and provides that the tax shall be a lien, from the time it is due and payable, upon "all and singular the right, title and interest of the person to whom such royalty is payable, in and to the land for permission to explore, mine, take out and remove ore on which the royalty is paid."

The admitted facts show that the defendants are threatening to enforce the iron ore royalty tax against the appellants, and have demanded that the appellants pay the taxes, and are threatening to assess the taxes against the plaintiffs and their respective property interests, and to certify the taxes and penalties in accordance with the provisions of the statute so as to cause them to become a lien upon the respective property interests of the plaintiffs, and to cause a cloud upon their respective titles. Defendants are also taking measures to require the appellants to file reports as required in the statute. The amount of taxes which the defendants are threatening to levy and collect from the appellants in this case, for the year 1923, would be upwards of $50,000, and for each of the years thereafter during the unexpired terms of the respective leases, a sum the amount of which cannot now be stated but which would in all events exceed $3,000 (pp. 2 and 12).

The Record establishes the following facts relating to the business of mining iron ore as conducted in the State of Minnesota:

All the known iron mines in Minnesota are in the northern and northeastern part of the state. The iron ore deposits constitute substantially the entire value of these lands. In 1923 there were 124 mines in operation, producing upwards of 45,000,000 tons of ore. In the majority of instances they were operated by lessees, but in four cases they were operated by fee owners. The lessees paid a total in royalties of upwards of $16,000,000, of which amount approximately $9,500,000 was reported as being received by resident owners, approximately $1,500,000 by foreign corporations, and considerably more than $5,000,000 by non-residents of the State.

At various times 243 iron mines have been in operation of which 45 have been exhausted. Of the mines operated in 1923, approximately one-half, which involved three-fourths of the tonnage mined, were mined by the open pit method (p. 17).

The total tonnage of merchantable ore in Minnesota is estimated at 1,300,000,000 tons. Of this 344,000,000 tons are held free from lease by various subsidiaries of one corporation. The present intention of said corporation and its subsidiaries is that these be mined by one of the subsidiaries, which is an operating company, without the payment of any royalty. During 1923 one mine was operated by such an arrangement.

During the last few years preceding 1923 there have been a number of instances in which iron ore properties not subject to lease have been sold outright and the fee transferred for a cash consideration, and a number of instances in which the fee of iron ore properties has been purchased by the lessee and the lease thereon cancelled. In 1923 there were at least two, and possibly more, instances in which fee owners of iron ore land which was not subject to lease sold the same for a cash consideration, or its equivalent, one of

which consisted in the purchase of an undivided one-sixteenth interest in fee by a company which already held a lease on the remaining fifteen-sixteenths interest. There was one instance in 1923 where an undivided eleven-thirty-seconds of the interest in fee was sold subject to an existing lease, the purchaser of said undivided fee interest and the lessee under said subsisting lease being companies having the same stockholders. There was another instance in 1923 of the sale of the fee interest, which is described in the agreed statement of facts in *Bardwell et al.* v. *Sargent Land Company et al.* tried herewith.

As bearing on the discriminatory nature of the tax here in question, the Record shows that several million yards or tons of gravel are taken from pits throughout the State each year by mining operations quite similar to the open pit methods of mining ore. A number of the most important gravel pits are operated on a royalty basis. Much of this gravel is used in making and keeping up roads and railroad rights of way and in building operations conducted within the State.

The Record also shows that it has been the practice in Minnesota for many years to lease real estate, both urban and agricultural, for rentals, cash or otherwise, and this was true during the year of 1923. Chapter 226, General Laws of Minnesota 1923, is the only statute providing for a tax on rentals.

III.

The Tax Legislation of Minnesota.

The General Tax System in force.

Before proceeding to an analysis of the royalty tax of 1923 it will be helpful to review briefly the general system of taxation which was in force in Minnesota when the new tax law was adopted.

The only constitutional provision in effect in Minnesota, on the general subject of taxation, is the requirement in Section 1, Article IX, of the Constitution that "taxes shall be uniform upon the same class of subjects".

With the usual exemptions, all real and personal property in Minnesota is subject to *ad valorem* taxation. Real and personal property is classified for purposes of taxation, the statute requiring that agricultural products be valued at 10% of their true value, live-stock, tools, machinery, etc., at 33⅓% of their true value, household furniture, etc., at 25% of true value, real estate, if platted, at 40% of its true value, and if not platted, at 33⅓% of its true value, and ore, whether mined or unmined, at 50% of its true value. In other words, the State tax laws already impose a heavy and unequal burden upon property containing iron ore. § 1993, Gen. Stats. Minn. 1923.

A special provision of the State Tax Law subjects "money" and "credits" after deduction of "debits" to a special tax of three mills on the dollar, and exempts them from all other taxation. *Ibid,* Sec. 2337*ff.*

In addition to this system of *ad valorem* property taxation, the State of Minnesota has adopted a system of so-called "lieu taxes" imposed upon certain kinds of corporations. Thus, railroad companies are subject to a tax upon the portion of their gross earnings properly attributable to business done within the state, after deducting rentals; express companies and freight line companies are subject to a similar tax after deducting all moneys paid for transportation; and

insurance companies, to a special tax upon gross premiums less return premiums. There are similar taxes affecting trust companies and telephone companies. In each case the taxing statute provides that the tax therein imposed shall be in lieu of all other taxes (or, in the case of the insurance company tax, in lieu of all taxes except real estate taxes). The constitutionality of these so-called lieu taxes has been sustained by this court, even as applied to corporations engaged in interstate commerce, upon the express ground that the tax is in lieu of all other taxes, and is "not in excess of what would be legitimate as an ordinary tax on property, taken at its real or full value." *U. S. Express Co.* v. *Minnesota*, 223 U. S. 335; *Cudahy Packing Co.* v. *Minnesota*, 246 U. S. 450.

Special Taxes Relating to the Mining of Iron Ore.

On April 11, 1921, the Minnesota Legislature adopted a so-called occupation tax, on "the business or occupation of mining ore", which marked a distinct departure from the previous policy of the State, in that it was not a lieu tax but was expressly stated to be in addition to all other taxes already imposed. §2373, General Statutes of Minnesota, 1923. The amount of the tax was 6% of the valuation of the ore produced during the year. The valuation of the ore was arrived at by deducting from its value after it had been brought to the surface, (*a*) the cost of bringing the ore to the surface; (*b*) a proportionate share of the cost of sinking and constructing shafts and running drifts, or, in the case of open pit mines, of removing the overburden; (*c*) the amount of royalties paid on the ore mined or produced; (*d*) a percentage of the *ad valorem* taxes on the realty. It should be noted that the deductions include a part only of the costs of mining, no deduction being allowed on account of costs of exploration, overhead, interest on investment, personal property taxes, or depreciation of plant, equipment, tools, etc.

The constitutionality of this statute was sustained by this court in *Oliver Iron Mining Co.* v. *Lord*, 262 U. S. 172, the court taking the view that the tax was what it purported to

be, namely, an occupation tax, and that such a tax could properly be imposed upon the business of mining iron ore without creating either an unconstitutional discrimination or an undue burden upon interstate commerce.

On April 11, 1923, the Minnesota Legislature adopted the statute involved in the case at bar, imposing a tax of 6% on "all royalty received * * * for permission to explore, mine, take out and remove ore from land in this state." "Royalty" was defined as "the amount in money or value of property received by any person having any right, title or interest in or to any tract of land in this state, for permission to explore, mine, take out and remove ore therefrom." The tax was on the gross amount, no deductions being allowed on account of taxes paid, administrative or legal expenses of collection, amortization of capital investment, or any other expense involved in collecting the royalties.

The lower court in the present case took the view that the two acts were complementary; that the legislature looked upon ore lands as a taxable resource of the state which was gradually being exhausted by depletion of the mines; and that the two tax laws were designed to intercept and gather in to the state treasury a part of the value of this asset to the extent that it was being dissipated, the first law being designed to reach the value of the ore underground to the extent of the lessee's interest therein, and the second to the extent of the lessor's interest, as evidenced by his right to receive royalties.

It should be observed, however, that the two taxes are by no means equivalent. In fact, the contribution exacted from the person receiving royalties is much more onerous than the contribution exacted either from the lessee, who is operating the mine, or from the fee owner, who works his own property. This is true in the following respects:

1. The occupation tax is payable only with respect to ore actually mined and brought to the surface. If the mine is idle, or if the deductions allowed are greater than the value of the ore, as sometimes happens, no tax is payable. The royalty tax is payable whether or not the

royalty was received on account of ore actually mined. A royalty contract may provide a guaranteed minimum royalty, payable monthly or quarterly, whether or not ore is actually mined. (Indeed, it is common knowledge that such provisions are almost universal in ore royalty contracts.) The royalties received by the lessor under the guarantee are plainly taxable under the terms of the statute, which imposes a tax upon all royalty received "*for permission to* explore, mine and take out and remove ore from land in this state." Yet, where the mine is idle, neither a lessee nor a fee owner working his own mine has to pay the occupation tax.

2. In the second place, the lessee, or the fee owner working his own mine, may deduct a proportionate share of real estate taxes from the valuation of the ore upon which the occupation tax is based. In Minnesota, as in other states, real estate taxes are payable primarily by the owner of the land, whether or not it is subject to lease (except where the lessor is the State or some other body exempt from tax, in which case the tax laws make special provision for taxing the leasehold (Sec. 1996, Gen. Stats. of Minn., 1923)). If the lessor of iron ore has to pay such a tax, and is not, for one reason or another, in a position to obtain reimbursement from the lessee under the terms of his royalty contract, he is nevertheless not permitted to deduct the taxes from the amount received as royalties.

3. The lessee, or fee owner working his own mine, may deduct amortization on the cost of shafts and drifts constructed by him, or the cost of removing the overburden in the case of open pit mines. If, however, the lessor has incurred expenditures of this character before executing the lease (the expenditures being taken into account in fixing the royalty) he cannot deduct amortization of these expenses from the royalties taxable under the statute.

4. The final and most important difference grows out of the nature of the two taxes. One is an occupation tax, and hence an indirect tax, which becomes part of the cost of

mining, and can generally be shifted in large part to the consumer. The other is a tax upon income received from land, is a direct tax, and its incidence falls exclusively on the lessor of the land.

We shall return to these differences later, but mention them now as they are essential to a proper analysis of the two tax laws and of their relation to each other.

IV.

Legal Character of the Royalty Tax.

The Appellants' Interest in the Question.

Where the issue is whether a tax goes beyond the scope of reasonable classification sanctioned by state and federal constitutions, the precise name which shall be given to the tax, whether it is a license or excise tax, a property tax, or an income tax, is not always important. A tax may be so clearly motivated by a spirit of arbitrary and hostile discrimination that it is invalid, whatever category it may belong to. However, the considerations which affect the reasonableness of a classification may depend in part upon the incidence and legal character of the tax, and in any event we believe it will be necessary to clarity, before proceeding with the argument, to analyze briefly the nature of the tax imposed by the Act of April 11, 1923.

In order to be entirely frank, however, we should state that there may be differences of opinion regarding the real nature of the tax, between the appellants in the different cases now pending before this court involving the Minnesota royalty tax, which differences may or may not be relevant in connection with the cases at bar, but which have a bearing on another question of importance not now before the court. Without going into detail, it is sufficient to state that the appellants in this case, while appearing here in their capacity as lessors, have much larger interests in Minnesota as lessees and operators of ore lands. The leases

in many cases contain covenants providing that taxes upon the land shall be paid or reimbursed by the lessee, and if the present royalty tax should be held to be constitutional, the question would at once arise whether it was such a tax as was contemplated by the covenants in question. An analysis of the tax has led us to the conclusion that the tax is not a tax upon the land. Except insofar as the necessities of the case at bar require, we shall not, of course, attempt to argue the question here, but inasmuch as an analysis of the statute is essential to the presentation of the case at bar, it seems only fair to the court that we should state frankly the collateral interests which our clients may have in the question.

Legal Nature of Royalty Contracts.

It is settled by a series of decisions only recently reaffirmed in this Court, that royalty contracts of the kind here involved are not contracts for the sale of ore at a price per ton, or conveyances of a part interest in ore under ground, but true leases (without impeachment for waste). It is settled law that the royalties are rentals, of the same legal character as rentals for farm land, and constitute a part of the current income derived from the land, rather than the proceeds of realization of its capital value. Under the corporation excise tax, it was held that royalties must be included in gross income, and that no deduction could be made on account of depletion of the mine. This was held to be true even where it was shown that substantially the whole value of the land lay in the ore body, and that the ore body would be completely exhausted within a definitely ascertainable period.

Von Baumbach v. *Sargent Land Co.*, 242 U. S. 503 (1917);

U. S. v. *Biwabik Mining Co.*, 247 U. S. 116 (1918);

Goldfield Consol. Mines Co. v. *Scott*, 247 U. S. 126 (1918).

For purposes of a state property tax, the Supreme Court of Minnesota has held that royalty payments not yet due constitute an interest in realty; but that as soon as the royalties mature and become payable they are "credits" and constitute personal property, the same as any other monies payable to the taxpayer.

State v. *Royal Mineral Ass'n*, 132 Minn. 232 (1916).

These decisions do not, of course, hold that royalties constitute net income. The decision is merely that for historical and technical reasons, although really constituting in part a conversion of capital investment into cash, royalties are to be considered as a part of gross income. Royalties do not constitute net income until all expenses and deductions incident to the realization of the income have been subtracted.

The Statute does not Impose a Tax on Property.

Both in the Act of 1921 and in the Act of 1923 the Legislature seems to have studiously avoided imposing a tax on property of any kind. Both statutes are carefully drawn, and suggest a conscious effort to avoid entirely the field of property taxation. Accepting the analysis of the court below in the case at bar, and the statements of the sponsors of the legislation (see Appendix B of this brief), the purpose of the Legislature was to draw into the treasury a part of the value of all iron ore mined within the State. The simplest way of accomplishing such a purpose would have been by imposing a special property tax, or capital levy, upon the ore in the ground or after it was mined. However, under the decisions in Minnesota, as well as under similar constitutional provisions in other states, a special property tax imposed upon one kind of property, not in lieu of but in addition to the regular *ad valorem* taxes, would have been clearly unconstitutional. In *State* v. *Canda Cattle Car Co.*, 85 Minn. 457 (1902), the Supreme Court of Minnesota had declared that "where the method adopted is a tax upon prop-

erty based on valuation, the rate imposed must be uniform, and apply alike to all who are thus taxed".

In *State* v. *Farmers & Merchants Savings Bank*, 114 Minn. 95 (1911), the court sustained, as a property tax, a tax on the "franchise" of savings banks measured by their assets, including personal property, after deducting deposits and accounts payable. On rehearing it developed that $3,750 of office furniture had been included in the valuation of the franchise, and had also been separately assessed as personal property. The court reversed itself as to this item, and said:

> "Since this property had already been taken into consideration in determining the surplus, it could not be separately taxed. Such a course would result in double taxation, which is forbidden by the Constitution, and is not authorized by the statute. * * *
>
> "Although special reference may not have been made in the opinion to Sec. 1, Article 9, of the State Constitution, the argument and decision were intended to include a consideration of the requirement that taxes must be uniform upon the same class of subjects."

In the *Ohio Tax Cases*, 232 U. S. 576, a railroad tax was attacked on the ground that it violated the uniformity clause of the Ohio constitution. It was sustained by this court on the express ground that it was not a tax on property, but a tax on the privilege of doing an intrastate business within the state.

In *Waring* v. *Mayor & Aldermen*, 60 Ga. 93, and *Hattiesburg Grocery Co.* v. *Robertson*, 126 Miss. 34, tax laws regarded as violating the uniformity clauses of state constitutions, if construed as property taxes, were sustained as franchise taxes.

In the *Kentucky Distilleries* case, 255 U. S. 288, a tax on whisky, which, this court held, could not be construed as a license or excise tax, was condemned under the state uniformity clause, as an additional tax on property already subject to tax.

The view that a special tax upon one particular kind of property would violate the constitution of Minnesota is further indicated by the fact that it was considered necessary in 1921 to adopt a special constitutional amendment authorizing the taxation of motor vehicles using the public streets "on a more onerous basis than other personal property", the amendment requiring, however, that the new tax be "in lieu of all other taxes thereon, except wheelage taxes". The tax was held to be a property tax in *State* v. *Peterson*, 159 Minn. 269. That it was found necessary to adopt such an amendment clearly indicates the belief that, under the general constitutional provision that "taxes shall be uniform upon the same class of subjects", a special tax upon one form of property, not imposed upon other property falling within the same general class, would be unconstitutional.

In the Act of April 11, 1923, also, the Legislature made it clear that it intended to avoid the constitutional pitfalls which would be encountered in imposing a special property tax, although here, as we shall show, they were not so successful in saving the constitutionality of the tax. It was familiar tax lore that a law might be clearly invalid under the uniformity clauses of state constitutions if construed as imposing a tax on property, and yet could be sustained, within reasonable limits, if it could be construed as an income tax. *Waring* v. *Mayor and Aldermen of Savannah*, 60 Georgia 93; *Hattiesburg Grocery Co.* v. *Robertson*, 126 Miss. 34. The device adopted in the Act of 1921, imposing a business or occupation tax, was not available, since many of the recipients of income from royalties would undoubtedly be found not to be engaged in business within the state (see *post*, p. 17). The tax was imposed, therefore, not on the land, nor on the business of receiving royalties, but on the "royalties received", that is, adopting the definition in the statute, on "the amount in money or value of property received by any person having any right, title or interest in or to any tract of land in this state, for permission to explore, mine, take out and remove ore therefrom".

We do not suppose that the statute is to be taken literally as imposing a property tax on the physical money or other thing of value received by the lessor. Such a construction would raise so many questions of jurisdiction and situs that it would undoubtedly be rejected unless it were the only interpretation possible. A clear authority against such a construction, if one were necessary, would be *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S. 283. The transfer tax considered in that case was imposed literally upon "all property * * * which shall pass by will or by the intestate laws of this state." In sustaining the tax, this court stated, that "the tax is not on money, it is on the right to inherit * * *." In his dissenting opinion in this case Mr. Justice Brewer said: "It seems to be conceded that if this were a tax upon property, such increase in the rate of taxation could not be sustained, but being a tax upon the succession, it is held that a different rule prevails."

It seems obvious that what the Minnesota Legislature intended to tax was not the royalties received, but the receipt of royalties.

In a dictum near the close of the opinion of the court below, it is said that the tax "is essentially a tax upon the interest in the land owned by the person by whom the tax should be paid." This is not, of course, a statement that the tax is upon the land itself. A tax on land is a tax measured by the value of the land, or its acreage, or some other physical characteristic. It is levied against the land, and is a lien upon the land if unpaid. Moreover, the typical real estate tax is levied upon the whole interest in the land, and does not depend upon whether or not the land is under lease. The royalty tax here in question, on the other hand, has nothing to do with the value of the land, but depends upon whether or not it is under lease, and upon the amount of the royalty. It is not levied on the land, nor can the land as such be sold if the tax is unpaid. All that can be sold is the right of the lessor to receive royalties, and the reversion (if he is the owner thereof) after the lease expires.

What the court apparently had in mind was that the *res* subject to the tax was the lessor's interest in the realty, that is, the reversion and the right to receive royalty. To state the matter more accurately, the *res* was considered to be the right to receive royalty, considered as an incorporeal hereditament, since it is, of course, quite possible that the person entitled to the royalty is not the owner of the reversion. Considered in this guise, the statute encounters, as we have shown, obstacles under the State Constitution which it was the obvious intention of the Legislature to avoid. It singles out for property taxation one particular form of property, namely, reversions or royalty rights in lands containing iron ore. It does not even tax all such reversions or royalty rights, but only such as produce gross income to the owner during the year. In one case, the reversion may be of great value but the royalty small. In another case the royalty may be large but the reversion practically worthless; yet the more valuable reversion in the first case would be taxed at a lower rate than the less valuable one in the latter case.

It is difficult to see upon what reasoning the court based its dictum that the tax is upon the lessor's property rights, unless it was in the belief that, by attaching the taxable *res* to real property within the state, the application of the tax to non-resident lessors would be facilitated. Whether such application was intended by the legislature need not now be considered; we will assume for the purposes of the present argument that it was. It is now settled that a state may constitutionally tax income derived by a non-resident from property within the state.

Shaffer v. *Carter,* 252 U. S. 37.

This case sustained a tax imposed by Oklahoma on income derived by a resident of Illinois from Oklahoma oil and gas leases. There is no suggestion in the opinion of the court in *Shaffer* v. *Carter* that it was necessary to construe the tax as a property tax in order to sustain it. The only significance which the court attached to the presence of the prop-

erty within the state was that it afforded a practical means by which the tax on the non-resident's income could be collected if not voluntarily paid.

It is possible that the dictum of the District Court is attributable to certain language in some of the opinions in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 611. The income tax involved in that case was a general one, and in concluding that it was a direct tax within the meaning of the Federal Constitution the court relied largely upon the fact that taxable income might include income derived from lands. Here and there in the opinions there are suggestions that the tax, in this respect, was "a tax upon land". The opinions make it clear, however, that the court was discussing not the *res* which was subject to the tax, but the economic incidence of the tax in so far as it included income derived from land. The argument was that a tax upon rentals reduces the value of the land and therefore in an economic sense falls on the owner of the land. This line of reasoning is clearly indicated in the following extract from the opinion of Chief Justice Fuller in the case on rehearing (p. 618):

> "Our previous decision was confined to the consideration of the validity to the tax on the income from real estate, and on the income from municipal bonds. The question thus limited was whether such taxation was direct or not, in the meaning of the Constitution; *and the court went no farther, as to the tax on the income from real estate, than to hold that it fell within the same class as the source whence the income was derived, that is, that a tax upon the realty and a tax upon the receipts therefrom were alike direct; while as to the income from municipal bonds, that could not be taxed because of want of power to tax the source, and no reference was made to the nature of the tax as being direct or indirect.*" (Italics ours.)

Any suggestion that a tax on rentals is a tax on land (except in the economic sense above indicated) is entirely inconsistent with the interpretation of the *Pollock case* by this Court in *Brushaber* v. *Union Pacific* (240 U. S. 1).

In order to complete our analysis we should mention here another suggestion which seems to us clearly untenable, namely, that the royalty tax statute is in substance a business or occupation tax, imposed on the business of receiving royalty. We believe that the decision of this court in *Dawson v. Kentucky Distilleries Co.*, 255 U. S. 288, completely disposes of this suggestion. In that case the statute imposed a tax of 50 cents a gallon on all whiskey withdrawn from bond within the state, or transferred in bond to a point outside the state. The court pointed out that the tax could not be sustained as a tax on the business of removing whiskey from bond or from the state, because it would be payable even upon a single transaction, whereas a single transaction would clearly not constitute doing business within the state. The receipts by way of royalty are taxable under the apparent terms of the Minnesota statute whether or not the recipient transacts any business within the state, and even if he receives only a single item of royalty during the year. Nor is there any suggestion in the terms of the statute that an occupation tax was intended.

Not being a tax on the land as such, nor on the reversion or incorporeal hereditament owned by the lessor, nor on the royalties considered as money or other personal property, nor on the business of receiving royalties, our analysis leads us to the conclusion that the tax is exactly what it purports to be, namely, a tax on gross receipts by way of royalty from iron ore lands within the state. We believe that the legislature, familiar with the interpretation given to the state constitution, and to similar constitutional provisions in other states, intentionally gave the tax this form, in order to avoid the supposedly greater constitutional difficulties involved in imposing a direct property tax. We will attempt to show, however, that the effort to save the constitutionality of the tax failed, since even as a tax upon gross royalty receipts the statute violates the 14th Amendment of the Federal Constitution and Article 9, Section 1 of the Constitution of Minnesota.

V.

Specification of Errors Urged.

The Court erred:

I.

In dismissing plaintiffs' bill of complaint and entering a decree for the defendants.

II.

In holding that the tax imposed by Chapter 226 of the Laws of Minnesota 1923 is not in violation of Article I, Section 10, of the Constitution of the United States, which provides that "No state shall * * * pass any * * * law impairing the obligation of contracts."

III.

In holding that the tax so imposed is not in violation of Article IX, Section 1, of the Constitution of the State of Minnesota, requiring that taxes shall be uniform upon the same class of subjects.

IV.

In holding that the tax is not in violation of the provisions of the Fourteenth Amendment to the Constitution of the United States, securing to all persons within the state the equal protection of the laws.

V.

In holding that the tax is a tax on the interest of the lessors in mining properties, if by so holding the court intended to hold that the tax is a tax upon land.

VI.

In holding that the tax, if held to be a tax on land, is valid notwithstanding the constitutional provisions above referred to, although mining properties not operated are not subject to the tax.

VII.

In holding that the tax, if held to be a tax on land, is valid notwithstanding the constitutional provisions above referred to, although other wasting properties are not subject to the tax.

VIII.

In holding that the fact that iron lands are being depleted of their natural wealth furnishes any proper basis for classification under which they may be subject to special and double taxation.

IX.

In failing to hold that the tax, if held a tax upon land, operates unequally against the plaintiffs in that no corresponding tax is imposed upon any land other than mineral lands operated on a royalty basis, all in violation of the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of Minnesota.

X.

In failing to hold that the tax, if a tax upon the sale price or the proceeds of mineral lands or of the iron ore therein, operates unequally against the plaintiffs in that no corresponding tax is imposed upon the proceeds of the sale of any lands other than mineral lands and when such proceeds are received by way of royalties, all in violation of the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of Minnesota.

XI.

In failing to hold that the tax, if a tax on rents and profits of mineral lands, operates unequally upon the plaintiffs in that no corresponding tax is imposed upon rents and profits except when the same accrue to the owner thereof in the form of royalties, all in violation of the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of Minnesota.

XII.

In failing to hold that the tax, if an income tax, operates unequally against the plaintiffs herein in that no corresponding tax is imposed upon income from any other source, including income derived from mineral lands other than in the form of royalties, all in violation of the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of Minnesota.

XIII.

In failing to hold that the tax, if a tax upon moneys received as royalties, operates unequally against plaintiffs in that no corresponding tax is imposed upon moneys derived from other sources, and that such attempted classification of moneys and credits according to the source from which derived is unreasonable and invalid, all in violation of the Fourteenth Amendment of the Constitution of the United States and Section 1 of Article IX of the Constitution of Minnesota.

XIV.

In failing to hold that the tax is a hostile discrimination in the guise of a tax and, therefore, a denial of equal protection of the laws and a taking of property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States.

XV.

In failing to hold that the royalties received by the plaintiffs Lake Superior Consolidated Iron Mines and Northern Development Company, received by them in the State of New York, have no situs within the State of Minnesota for the purpose of taxation and are not subject to the tax imposed by said act.

XVI.

In failing to hold that plaintiff was entitled to the relief prayed for in the bill of complaint and to enter a decree permanently enjoining the defendants from enforcing the provisions of said act.

VI.

Summary of Argument.

(A) The Act is unconstitutional because the classification adopted is arbitrary and unreasonable.

The Minnesota royalty tax is imposed on gross income derived from iron ore royalties, no other form of rental or of income from land or from any other source being taxed. It is not imposed in lieu of property taxes, but in addition thereto. It is a direct tax and its burden cannot be shifted. Thus to single out income in the form of rental from one form of property for burdensome taxation violates the 14th amendment of the Federal Constitution and § 1, Article IX, of the constitution of the State of Minnesota.

The classification cannot be justified on the theory that iron ore is a "wasting asset". Moreover insofar as this theory rests upon the fact that a large part of the iron ore mined is shortly removed from the State, it is inconsistent with the spirit of the commerce clause of the Federal Constitution.

(B) The Act is unconstitutional because it operates in an arbitrary and unequal way upon the class or subject selected for taxation.

Even within the class upon which it operates, namely recipients of income from iron ore mines, the tax operates in an unequal and arbitrary way. Owners operating their own properties are treated differently from owners leasing their properties. Owners disposing of iron ore deposits by sale are treated differently from owners disposing of them on a royalty basis. The Act is therefore invalid because of lack of uniformity in its operation within the class selected.

VII.

The Argument.

A.

The Act is unconstitutional because the classification adopted is arbitrary and unreasonable.

The substantial question presented in this case is whether an attempt to put gross income from royalties in a class by itself, and to impose upon such income a tax not applicable to income from any other source, not in lieu of but in addition to the general property taxes, violates the equal protection clause of the Fourteenth Amendment or Article 9, Section 1, of the Minnesota Constitution.

We will not burden the court by multiplying quotations as to the broad power of classification permitted to the legislature. The decisions fall largely into two categories: Cases involving taxes imposed upon corporations, in lieu of ordinary property taxes, or in an effort to reach intangible elements of property not touched by general property taxes; and cases involving business or occupation taxes. Even *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245, involved a

tax which, while in form a tax on coal, was payable only on coal mined during the year and ready for shipment. In substance it was an excise tax on the mining of coal. It is settled that the business or occupation of mining iron ore can be made the subject of a special occupation tax not imposed on other types of business. *Oliver Iron Mining Co.* v. *Lord, supra.*

The Minnesota royalty tax does not, as has been shown, fall within either of these categories. It is not a tax imposed in lieu of all other taxes and it cannot be construed as an occupation tax on the business of receiving royalties (even assuming that such a tax would rest upon a proper classification). It is a tax on money (or its equivalent in property) received in the form of royalties. Whatever may be the scope of classification in the case of occupation taxes, it is submitted that money received as royalties cannot be singled out and placed in a class by itself. Money received as royalties is no different from money received as income in any other way There is clearly no distinctive character to the income itself which could be urged as a basis for classification. Can the State nevertheless classify it according to the source from which it is derived? Granted that the State can classify income according to its source, can it single out the income from iron ore lands? Can it go still farther and single out income derived from such lands in the form of royalties for separate and highly burdensome taxation? It is our contention that, with certain exceptions which are not applicable here, income cannot be classified according to its source, but that, even if it were possible to classify income according to its source, the singling out of income derived in this particular way from this one source is intrinsically an arbitrary selection and further, when viewed in the light of certain facts of which the Court may take judicial notice, is a hostile and oppressive discrimination.

A tax on the income derived from business or personal services is only one form of an occupation tax and here there

is a particularly wide range of classification permissible. Again there are various constitutional provisions which may justify or require the exemption of income from certain sources, but in general there is no justification for classifying income derived from property or investments according to its source. Income is income. Money received as income from one form of property is no different from money received from another. The income received from renting farm lands is no different from the income received from renting mineral lands. It is just as arbitrary to classify the receipt of income according to its source as to classify the money or other property when received according to its origin. It has been held in cases involving property taxes that it is improper to discriminate against particular property merely on account of its origin.

Illustrating this is the case of *People ex rel. Phillips* v. *Raynes*, 136 App. Div. 417, affirmed in 198 N. Y. 539, which involved a license tax on persons selling convict goods. The Appellate Division, First Department, in holding the classification "unreasonable and capricious", pointed out that the classification was based upon the origin of the goods dealt in without regard to the quality or character or nature of the goods themselves.

So in *State* v. *Hoyt*, 71 Vt. 59, in which a law imposing a license fee upon peddlers selling goods which were manufactured in Vermont was held unconstitutional. The Court held that the tax was one upon property, and that the only basis used for classification was the origin thereof, and further held that goods manufactured in Vermont were no different from goods of the same kind manufactured in New Hampshire or some other state, and the attempted classification upon the basis of the source or origin of the goods was unconstitutional as being without any relation to the subject matter or the purpose of the tax.

The case of *Woodruff* v. *Oswego Starch Factory*, 177 N. Y. 23, is no authority for the proposition that income in the form of rents may be separately classified with reference to its source. In that case the law provided that rents reserved

should be capitalized and taxed as personal property belonging to the lessor. Apparently when so classified they were merely dealt with as all other personal property and subject to the general personal property tax.

We do not mean to imply that some degree of classification of income is not proper in connection with general income taxes. The classification is proper if it turns upon some reasonable difference in the nature or condition of the taxpayer. Some classes of taxpayers may be exempted entirely and as to others the tax may be graduated according to the taxpayer's ability to pay. Corporations may be taxed differently from individuals, and public service companies differently from commercial concerns. *Atlantic Coast Line R. Co.* v. *Daughton*, 262 U. S. 413. "Earned" income may, no doubt, be taxed differently from "unearned", for here again there is a valid classification based on the taxpayer's ability to pay and on the policy of the government to encourage productive work and discourage idleness. Again income from capital gains can no doubt be taxed at a different rate from current income. These are classifications based on inherent and relevant characteristics, and bear no resemblance to a classification which singles the gross sums received as rental from a particular type of property, no other rental and indeed no other form of income being similarly taxed.

Between an occupation tax on the business of mining and a tax upon gross income from royalties there is a fundamental distinction which must not be lost sight of.

Whether a tax is levied as an occupation tax or as in the *Heisler* case in the form of a property tax upon the "manufactured" product at the instant it is ready for market, it is in the economic sense an indirect tax. The burden of the tax will normally be shifted to the public. At the outset there is necessarily some hardship particularly where there is close competition with some industry not burdened, but later as the tax is shifted to the public superficial inequalities are ultimately equalized. The royalty tax, however, cannot be classed with taxes such as these. We have seen that it is

a tax upon the income from land. As such it is in the economic sense a direct tax. The recipient of royalty must bear the full burden of any discrimination,—he cannot shift it to the public. Since the value of his property is largely determined by the capitalized value of the income anticipated from it, a tax upon that income will immediately, if it is deemed to be a permanent tax, diminish *pro tanto* the value of the source of income. If the royalty tax should be sustained it would decrease by six per cent. the value of all reversions to which the royalties are incident. In dealing with taxes of this character the refinements of classification must be very closely scrutinized lest taxation degenerate into confiscation. Certainly the possibilities of abuse in classification are far greater here than in the case of taxes which place burdens upon industry.

Perhaps it was this very distinction which this court had in mind in the *Oliver* case when it stressed the fact that the tax there considered was not a property tax but an occupation tax and valid as such. At 262 U. S. 179, it is said:

> "Consistently with both provisions the legislature of the State may exercise a wide discretion in selecting the subjects of taxation, *particularly as respects occupation taxes.*"

While taxes upon businesses or upon their products have quite commonly singled out particular industries or products, all the force of tradition is opposed to any subclassification of real property or of income therefrom. We can find very few cases where attempt was made to subdivide the general class of real property. The absence of any such cases is not without significance. A tax on land suggests at once the general property tax embracing all lands except the very small exempted class of lands devoted to charitable, religious and educational purposes. It does not suggest a series of separate taxes on farm lands, grazing lands, forest lands, city lands, etc. In a decision of this court, which according to 1 Cooley's Taxation, 4th Ed., at page 535, is

"cited more often * * * than any other decision" as an authority for allowing to the Legislature a wide range of classification, we find no suggestion that such a subclassification would normally be appropriate. The case is *Bell's Gap Ry. Co.* v. *Pennsylvania,* 134 U. S. 232. It holds (p. 237) that the Fourteenth Amendment

> "was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries, and the property of charitable institution. It may impose different specific taxes upon different trades and professions, and may vary the rates of excise upon various products. It may tax real estate and personal property in a different manner. It may tax visible property only, and not tax securities for the payment of money. It may allow deductions for indebtedness, or not allow them. * * *"

Again in *Home Insurance Company* v. *New York,* 134 U. S. 594, the Court speaking through Mr. Justice Field said (p. 606):

> "But the amendment does not prevent the classification of property for taxation—subjecting one kind of property to one rate of taxation, and another kind of property to a different rate—distinguishing between franchises, licenses and privileges, and visible and tangible property, and between real and personal property."

The contrast between these statements and the quotation from *Oliver Iron Mining Co.* v. *Lord,* given at page 27, *supra,* shows very plainly that there is a real distinction between attempts to subclassify real property and classifications as applied to taxes burdening industry.

It is easy to imagine the far-reaching consequences of a failure to observe this distinction and the adoption of a rule which would permit a subclassification of income from real property according to any superficial characteristic which may mark it off in the popular mind. The Legislature might

tax the income from farm lands and exempt income from city property; might tax income from farms containing more than eighty acres and exempt income from smaller farms; might tax income from farms having clay soils and exempt income from farms of sandy soils; might tax income from land lying at more than a certain heighth above sea level and exempt income from land at a lower level. That combination of property owners which happened to be politically dominant could shift the burden of taxation to some artfully selected class of property owners who happened to have slight political power. Unless the courts would define some limit to the amount of taxes, classification would become a synonym for confiscation and there would be no security in the ownership of land or other property of a fixed and permanent character.

It is not contended by us that under no conceivable circumstances could the income from real property be subclassified as a subject of taxation. It is conceivable that various circumstances might arise in which it might be shown that such a subclassification had some reasonable relation to some legitimate legislative policy. But in the light of tradition such a sub-classification is *prima facie* to be viewed with suspicion, because normally such a subclassification would not have any relation either to the benefits received by the owners of such property or their ability to pay taxes, nor to any policy in promoting the industry of the State, nor to anything else but the desire of the politically dominant to place an undue portion of the burdens of taxation upon a class of persons having slight political power.

But it is not necessary to resort to a speculation as to the possibilities of abuse which would be opened up by the sustaining of this tax. The tax itself is both burdensome and highly unfair, and its unique character, interpreted in the light of the history of the times, indicates quite plainly that it was designed to accomplish a hostile discrimination against a class, the recipients of royalties, many of whom are nonresidents of this state.

The full extent of the discrimination only appears when we consider that the income singled out for taxation is from a source already bearing a disproportionate share of the burden of taxation. Under an earlier law now appearing as Section 1993 G. S. 1923, lands from which royalties are derived are taxed at a higher valuation than other property. This act provides for the separate valuation of the surface and the underlying ore. Iron ore whether mined or unmined is valued at 50 per cent. of its true value while realty other than ore lands is assessed at 40 per cent. of its true value if platted and at 33⅓ per cent. of its true value if not platted. The constitutionality of the sections of this act which thus attempt to subclassify real property and to value differently the subclassifications has never been passed upon either by this court or by the Supreme Court of Minnesota. Even taken by itself the earlier act seems to us to involve an arbitrary discrimination against the owners of ore lands. Nevertheless it may be that differences in the feasibility of valuations or in the benefits received would justify a relatively slight discrimination, but the discrimination is so marked that such arguments must be stretched to the breaking point in order to afford a justification for it. They surely cannot be urged to justify the piling of discrimination upon discrimination to the extent effected by the royalty tax.

Section 1993 of the General Statutes 1923 is also significant as a forerunner of a series of acts and proposed acts culminating in the royalty tax which taken together evince a determined policy to single out those who derive income from ore lands for highly burdensome taxation. Many of these persons are nonresidents; in fact, nonresident individuals and corporations received nearly 50 per cent. of the royties paid in 1923.

The acts we have in mind include among others the tonnage tax act of 1919 which was vetoed by Governor Burnquist, the act proposing a constitutional amendment (afterwards adopted) authorizing an occupation tax and placing

a part of the proceeds thereof aside for future generations, the occupation tax involved in *Oliver Iron Mining Co.* v. *Lord, supra,* and finally the royalty tax. In addition to these legislative acts we ask the court to take judicial notice of certain extracts from the messages of Governors Burnquist and Preus and also an extract from Chapter 5 of the Seventh Biennial Report of the Minnesota Tax Commission published in 1920. These are collected in Appendix B to this brief.

In determining the object of the Legislature and its real intent, the court will consider the history of the times.

United States v. *Freight Assn.,* 166 U. S. 290, 318, 319;

Church of the Holy Trinity v. *United States,* 143 U. S. 457, 463;

Ross v. *Schooley,* 257 Fed. 290, 291 (certiorari denied 249 U. S. 615);

United States v. *Union Pacific R. R. Co.,* 91 U. S. 72, 79, 81;

Platt v. *Union Pacific R. R. Co.,* 99 U. S. 48, 59, 64.

The court may resort to messages of executives and reports of administrative bodies to the Legislature.

Johnson v. *So. Pac. Co.,* 196 U. S. 1, 19;

Clendaniel v. *Conrad,* 3 Boyce, 549;

Woodward v. *DeGraffenried,* 238 U. S. 284, 295.

Of the various arguments urged in support of taxes burdening those who own ore lands or are identified with the iron mining industry there is one line of argument which is particularly significant. It is referred to both in Governor Burnquist's veto message and in the report of the Tax Commission. This is the argument that iron ore is a heritage of the state and a wasting asset. As phrased by the Tax Commission the argument is:

> "Iron ore being a product of nature, its presence in the ground not being the result of the expenditure of capital or labor, is a natural heritage of all the people, and as such, the people are justified in appropriating to

their use, in some form of taxation, some considerable part of the value arising from its exploitation.

"That it does not reproduce itself, therefore its value is diminished by use through depletion, and that because of this diminishing value it should bear a heavier tax than other forms of natural property not diminished by use.

"That under existing conditions the bulk of this great natural heritage is gradually being removed from the state to enrich other states, and that eventually its value as a taxable state asset will have disappeared through depletion due to shipments, and in its place will be found only valueless 'holes in the ground', and that for this reason the state is justified in exacting a heavy toll in the form of super-tax for the depletion and disappearance of its natural wealth."

The fact that such arguments as this were generally advanced in support of the act, the fact that nearly 50 per cent of the royalties would be paid to nonresidents, and the fact that the iron mines are all located within a relatively small area in the northeastern part of the state, all point to the conclusion that there has been a deliberate attempt not to tax but to seize property under the guise of taxation by singling out for discriminatory action those who receive income from ore lands in the form of royalty.

Throughout the legislative history of this law, as well as in the opinion of the court below, we find implicit this thought that the tax can be justified because iron ore is a "wasting asset", which will sooner or later be exhausted, leaving the state nothing to tax. The same justification was urged in support of the Act of 1921, but in this court that act was sustained as an occupation tax, and there is no suggestion in the opinion that the court gave any sanction to this curious theory. In the present case, however, there is no basis for sustaining the tax as an occupation tax, and its supporters have to rely even more heavily upon the "wasting asset" theory.

The theory is that farm land, or timber land subject to reforestation, or city property, yields an annual income with-

out impairing the value of the *corpus* of the property. The land is always there, an unending source of revenue to the state. But mining property is gradually depleted by use; hence the state must make haste to gather as much as it can by way of tax before the ore is entirely exhausted. The difficulty with this theory is that if ore property is a wasting asset from the point of view of the state, it is just as much a wasting asset from the point of view of the owner. Suppose that an investor purchases today, for $1,000,000 a mining property which has a probable life of twenty years and which will be substantially worthless at the end of that period. To maintain his investment intact, he must not only obtain a reasonable return on the $1,000,000, but an additional amount sufficient, if accumulated, from year to year, to restore the $1,000,000 at the end of twenty years. Part of what he receives is a return on investment, part of it represents capital converted into cash. If Minnesota had a general tax on all net income, it would undoubtedly permit owners of mining property to deduct from receipts by way of royalties an annual item of depletion, in recognition of the fact that ore is a wasting asset. In the present case, by a strange twist of logic, the fact that ore is a wasting asset is seized upon not as a reason for granting indulgence to the taxpayer, but as a reason for singling him out for special taxation not applicable to recipients of other forms of income. The recipient of iron ore royalties is not even permitted to deduct a reasonable allowance for depletion. Far from affording a justification, the fact that iron ore is a wasting asset merely heightens the injustice of the tax. The fact that human energy and capacity is a wasting asset has been advanced as a valid reason for taxing so-called "earned" income at a lower rate than income from property or investments. We have never heard it advanced as a reason for imposing a special tax on "earned" income, not imposed on income from other sources. The "wasting asset" theory, as advanced by the supporters of this legislation, would warrant a special

tax on income of men over sixty years old, on the ground that they will soon cease producing any income for the state to tax.

The argument with regard to "wasting assets" needs to be further analyzed in another direction. Ore mined, manufactured and used in the State of Minnesota is not, of course, withdrawn from the State's taxing power. If it is converted into the steel girders of an office building or the rails of a common carrier, it is not only retained within the state, but at a greatly increased value. It is withdrawn from the taxing power only when it is either used up or exported from the state. The significant fact upon which classification of royalties derived from iron ore was based was not the fact that the ore is gradually extracted from the ground, but that a large part of it is usually exported from the state. It is settled by *Heisler* v. *Thomas Colliery Co.*, 260 U. S. 245 and *Oliver Iron Mining Co.* v. *Lord*, 262 U. S. 172, that a tax does not improperly burden interstate commerce because it is imposed upon property immediately destined for use in other states, and of course we do not now ask a reconsideration of this question. However, it is one thing to sustain a tax otherwise found to be based upon a valid classification notwithstanding it "may indirectly or incidentally affect" interstate commerce. It is quite another thing to seize on the fact that the greater part of the property in question is to be exported from the state, as in itself a justification for a classification which cannot otherwise be justified. Clearly the commerce clause prevents the legislature from putting into effect a classification which has no "reasonable relation to any permitted end of government action" but is based entirely upon an apparent desire of the legislature to discourage or to seize part of the profits incident to the exportation of property from one state into another.

This court has repeatedly asserted that the Fourteenth Amendment strikes down hostile discriminations between particular persons and classes. In *Citizens' Telephone Co.*

v. *Fuller,* 229 U. S. 322, the court, after reviewing cases showing the breadth of the power of classification, said (p. 331):

> "They illustrate the power of the legislature of the State over the subjects of taxation and the range of discrimination which may be exercised in classifying those subjects when not obviously exercised in a spirit of prejudice and favoritism. *Cook* v. *Marshall County,* 196 U. S. 261, 274; *Missouri* v. *Dockery,* 191 U. S. 165. The cases decided subsequent to the decision in *Bell's Gap Railroad Co.* v. *Pennsylvania* have applied its principal to many varying instances. Granting the power of classification, we must grant Government the right to select the differences upon which the classification shall be based, and they need not be great or conspicuous. *Keeney* v. *New York,* 222 U. S. 525, 536. The State is not bound by any rigid equality. This is the rule:—its limitation is that it must not be exercised in 'clear and hostile discriminations between particular persons and classes.' See 223 U. S. 59, 62, 63. Thus defined and thus limited, it is a vital principle, giving to the Government freedom to meet its exigencies, not binding its action by rigid formulas but apportioning its burdens and permitting it to make those 'discriminations which the best interest of society require.'"

It is to be noted that the Court had in mind and expressly referred to discriminations between classes, presumably proper classes for taxation purposes.

In *Dane* v. *Jackson,* 256 U. S. 589, decided June 1, 1921, while the court held constitutional an act of Massachusetts providing for the distribution, in a way which was alleged to be violative of the due process and equal protection clauses, of an income tax, the Court also said that (p. 599):

> "Where, as here, conflict with federal power is not involved, a state tax law will be held to conflict with the Fourteenth Amendment only where it proposes, or clearly results in, such flagrant and palpable inequality between the burden imposed and the benefit received, as to amount to the arbitrary taking of property without compensation—'to spoliation under the guise of exerting the power of taxing.'"

The court cited in support of this statement *Bell's Gap R. R. Co.* v. *Pennsylvania,* 134 U. S. 232, 237; *Henderson Bridge Co.* v. *Henderson City,* 173 U. S. 592, 615; and *Wagner* v. *Baltimore,* 239 U. S. 207, 220.

The last cited case, *Wagner* v. *Baltimore,* which involved the constitutionality of a state assessment for the expense of a public improvement, after holding that the state might determine the amount of the assessment without giving an opportunity to the owners to be heard, said (p. 219):

> "We do not understand this to mean that there may not be cases of such flagrant abuse of legislative power as would warrant the intervention of a court of equity to protect the constitutional rights of land owners, because of arbitrary and wholly unwarranted legislative action. The constitutional protection against deprivation of property without due process of law would certainly be available to persons arbitrarily deprived of their private rights by such state action, whether under the guise of legislative authority or otherwise. But in the present case there is neither allegation nor proof of such disproportion between the assessment made and the benefit conferred as to suggest that the small tax levied upon this property would amount to an arbitrary exercise of the legislative power upon the subject."

In *Bell's Gap R. R. Co.* v. *Pennsylvania,* 134 U. S. 232, the Court, after stating generally the broad field in which a state may classify subjects of taxation, said by Mr. Justice Bradley (p. 237):

> "But clear and hostile discriminations against particular persons and classes, especially such as are of an unusual character, unknown to the practice of our governments, might be obnoxious to the constitutional prohibition."

This last quotation makes an appropriate text for a summary of our objections to classifying the income from ore lands separately as a subject of taxation. It is, as we have seen, an entirely unprecedented selection, an arbitrary subdivision of the traditional class, income from real property. It

places a very heavy burden upon the recipients of royalties, entirely out of proportion to what would be a just contribution on their part to the revenues of the State. No legitimate legislative policy has been suggested as affording a basis for the selection. On the contrary reference to the political and legislative history preceding the passage of the Act shows a desire to seize a portion of the income from property which was unwarrantedly regarded as a "heritage" of the State.

We therefore submit that the Act is unconstitutional because the classification adopted is arbitrary and unreasonable and shows an attempt to make a hostile discrimination against the recipients of royalties from iron ore.

B.

The Act is unconstitutional because it operates in an arbitrary and unequal way upon the class or subject selected for taxation.

Even if we could assume that gross income derived from iron ore might be selected as a subject of taxation, it would still be necessary, both under the 14th Amendment and under the express terms of Article 9, Section 1 of the Minnesota constitution, that all gross income falling within that class be treated alike. Even this result has not been accomplished by the Minnesota legislature, as the Royalty Tax law discriminates in a purely arbitrary manner between recipients of such income by way of royalties, and recipients of similar income in other forms.

We have already pointed out the serious discrimination between lessees, or owners who operate their own properties, and owners who lease their properties on a royalty basis (see p. 8 of this brief). The owner, operator or lessee pays a tax which has many, though not all, the protective features of a net income tax. He may deduct the cost of bringing the ore to the surface, taxes, royalties, and

amortization on the cost of certain capital improvements. The owner-lessor is allowed no deductions whatever. If the lessor, prior to making his lease to the operating lessee, incurred expenditures in developing his property, such as stripping the surface or constructing shafts, drifts, etc., a part of the royalty which he receives represents amortization or reimbursement of the money so expended. He is nevertheless taxed for the full amount of the royalty, without any deduction on this account. If any discrimination is permitted between income by way of royalties and income by operation of lands leased or owned in fee, surely the discrimination should be in favor of the lessor rather than against him, for the operator can cease mining ore if he does not care to pay the tax; and in the long run the tax which he pays on the business of mining ore will be shifted to consumers. But the lessor, especially if he made his lease before the tax took effect, cannot cancel the lease, or shift the burden of the tax.

Another important discrimination is illustrated by the following case. Suppose that A is the owner of iron ore underground, and leases it for exploitation on a basis which will yield him about $100,000 a year royalty for twenty years, the mine being exhausted and the property valueless at the end of that period. B is the owner of a similar deposit, and sells it outright, the price being payable in twenty annual installments of $100,000 each, whether ore is mined or not. In their economic and financial aspects, the two transactions are substantially the same, except that in A's case the annual payment may be subject to a certain degree of fluctuation, while in B's case it is fixed. Yet A pays a tax of 6 per cent. on the annual payments, and B pays no tax.

Even between different recipients of income by way of royalty, there are discriminations of a serious character, if we look at the tax as one upon the income drawn from the land by the owner-lessor. The failure to make any allowances for depletion, while it does not rob the tax of its

character as an income tax, causes its burden in effect to fall largely upon capital value rather than upon income as such. This results in an inequality in the operation of the tax upon the recipients of royalties according to the proportion of depletion or capital conversion represented by their royalties. The case of the Merrimac Mining Company cited by other counsel is an illustrative one.

Again it is a fact disclosed by the record in companion cases that many of the lessors have spent very considerable sums for engineering, accounting and other matters connected with their mines. The failure to allow deduction of these items again results in an inequality between those lessors who incur such expenses and those who do not.

A fee owner may before leasing his mine strip and develop or sink shafts, drifts, etc. and thus invest large sums of money, leasing the property after the development is made and thus securing a return of his investment in development work in the form of royalties. Here again he is not allowed any deduction and pays the same rate of tax as the fee owner who has not sustained any such expense.

All of these are instances of unequal operation of the act within the class which it purports to select for taxation, that is, income or royalties received for permission to explore, for mining and removing iron ore. The act is invalid because of the lack of uniformity in its operation within the class.

VIII.

Conclusion.

In conclusion, we submit that the decree of the District Court, dismissing the bill of complaint, must be reversed with a direction to the Court to grant to the plaintiffs (appellants herein) the relief prayed for, and that the defendants be perpetually restrained from attempting to enforce the provisions of the Minnesota Royalty Tax (Chap. 226, Laws of 1923) against any of the appellants herein.

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APPENDIX A.

Text of Act.

CHAPTER 226—H. F. No. 29.

An act providing for the levy and collection of a tax on royalty received by the owner of any right, title or interest in land situate in this state for permission to explore, mine, take out and remove ore from the same.

Be it enacted by the Legislature of the State of Minnesota:

SECTION 1. Tax on iron ore royalties—Rate—There shall be levied and collected upon all royalty received during the year ending December 31, 1923, and upon all royalty received during each calendar year thereafter, for permission to explore, mine, take out and remove ore from land in this state, a tax of six (6) per cent.

SEC. 2. Definitions—For all purposes of this act the word "royalty" shall be construed to mean the amount in money or value of property received by any person having any right, title or interest in or to any tract of land in this state for permission to explore, mine, take out and remove ore therefrom; and the word "person" shall be construed to include individuals, copartnerships, associations, companies and corporations.

SEC. 3. Annual Reports to Tax Commission—Every person to whom royalty is paid shall on or before the first day of February, 1924, and annually thereafter on or before the first day of February of each year, make and file with the Minnesota Tax Commission, a report verified by the person making the same and setting forth the amount of royalty received by such person during the preceding calendar year, and such other information as said commission may require.

SEC 4. Contents of Reports—It shall be the duty of every person paying royalty, on or before the first day of February, 1924, and annually thereafter on the first day of February in each year, to make and file with the Minnesota Tax Commission, a report covering the preceding calendar year, verified by the oath of the person making the same and setting forth;

1. The number of tons mined from each tract of land for the right to mine and remove ore on which such person pays royalty.

2. The amount of royalty paid on each tract of land separately.

3. The name and post office address of each person to whom royalty is paid, and

4. Such other information as said commission may require.

SEC. 5. Tax Commission to Assess Tax.—Upon the receipt by the Minnesota Tax Commission of the report provided for in Section 3 of this act it shall determine from such information as it may possess or obtain, whether the same is correct or otherwise, and if found correct, said tax commission shall determine therefrom the amount of tax due from such person, and shall enter the amount thereof in its records and shall make its certificate of taxes due thereon from such person, and on or before the first day of May of each year file the same with the state auditor and a duplicate thereof with the state treasurer; and the tax commission shall have power, in case it shall deem said report incorrect, to make its findings as to the amount of such taxes due after hearing upon notice to the person interested, and its findings shall have the same effect as the determination of the amount of such taxes upon a report made as hereinbefore provided.

A person subletting land for the use of which he received royalty shall be required to pay taxes only on the difference between the amount of royalty paid by him and the amount received.

SEC. 6. Penalties for Non-payment—If any person subject to the tax provided by this act shall fail to make the report provided for in Section 3 of this act, at the time and in the manner therein provided, there shall accrue upon the tax herein imposed a penalty in an amount equal to ten per cent (10%) of the tax so imposed to be added to and collected with such tax. The tax commission shall in such case determine the amount of the ores mined or produced, together with the royalty paid thereon and shall fix the tax due thereon from such person, together with such penalty, upon such information as it may possess or obtain and shall proceed as provided by law when such taxes are determined upon the sworn report of the person receiving such royalty. Such findings shall stand in the place of the report required by this act to be made by such person and shall be in all courts of the state, for all purposes, *prima facie* evidence of the facts therein stated.

SEC. 7. Date of Payment—Such tax shall be due and payable on the first day of June, 1924, and annually thereafter on the first day of June, and if not paid on or before that date a penalty of ten (10 per cent.) shall immediately accrue thereon.

SEC. 8. Tax a Lien on Lands and Ore—The situs of royalty for all purposes of this act shall be in this state; and the tax herein provided for shall be a specific lien from the time the same is due and payable upon all and singular and right, title and interest of the person to whom such royalty is payable, in and to the land for permission to explore, mine, take out and remove ore on which the royalty is paid.

SEC. 9. Auditor to Make Draft—On or before the tenth day of June in each year the state auditor shall make his draft upon each person delinquent in the payment of such tax for the amount of taxes and penalty, or penalties, due thereon, and place the same in the hands of the state treasurer for collection.

The draft of the state auditor for the tax and penalties imposed by the foregoing provisions of this act shall be prima facie evidence in any court where proceedings may be brought for its enforcement that the amount therein stated is due the state from the person against whom the same is drawn.

SEC. 10. Treasurer to Collect Tax—The state treasurer within ten days after the receipt of the draft mentioned in Section 9 of this act shall notify by mail the taxpayer designated therein of the amount thereof and if not paid within thirty days after presentation shall deliver the same to the attorney general whose duty it shall be to bring an action thereon in the district court of Ramsey County for the amount of such draft, together with interest and costs of the proceedings. Such tax shall draw interest at the rate of one per cent. per month, commencing thirty (30) days after the same falls due; and the judgment of the court when so obtained and properly docketed shall be a lien upon all right, title and interest of the taxpayer to the land upon which such tax is a lien from the time the same is docketed; and said lien shall continue without limitation with interest at the rate of one per cent. per month and the said property may be sold in satisfaction of such judgment in the same manner as provided by law for the sale of property upon execution.

SEC. 11. Penalties for False Returns—Any person who for the purpose of evading the payment of the tax herein provided or any part thereof makes any false return or report shall in addition to the tax provided by this act pay a penalty of fifty (50) per cent. of the amount of said tax; and

any person who shall knowingly make under oath any false report or return required by this act shall be guilty of perjury and upon conviction thereof shall be punished therefor as provided by law.

SEC 12. Records to be Open to Inspection of Tax Commission—Violations and Penalties—All books, waybills, inventories, correspondence and memoranda relating to or used in the transaction of the business of any person paying or receiving royalty on ore mined in this state, shall upon request of the Minnesota Tax Commission be open to its inspection or examination. If any such person shall neglect or refuse on request of the Minnesota Tax Commission access to the papers and books aforesaid, he shall be guilty of a misdemeanor and upon conviction thereof shall be punished therefore as provided by law.

SEC. 13. Taxes to be Paid into General Revenue Fund—All taxes assessed, levied and collected under the provisions of this act shall be paid into the state treasury and credited to the general revenue fund.

SEC. 14. This act shall take effect and be in force from and after its passage.

Approved April 11, 1923.

APPENDIX B.

Legislative Acts and Extracts of Messages of Governors Preus and Burnquist and from the Report of the Minnesota Tax Commission of which the Court is Asked to Take Judicial Notice.

A much more complete collection of such speeches and documents can be found in the record of *Oliver Iron Mining Company* v. *Lord*, 262 U. S. 172.

1. *Extracts from Veto Message of Gov. J. A. A. Burnquist in Connection with the Tonnage Tax Act of 1919.*

"STATE OF MINNESOTA,
Executive Department, Sept. 19, 1919.

Hon. W. I. NOLAN,
Speaker House of Representatives:

"I am returning herewith without my approval House File No. 23, 'A bill for an act providing for the levy and collection of a tax upon the value of ore from persons, associations, corporations and joint stock companies engaged in the mining or production thereof.

* * * * * *

The whole subject, therefore, narrows itself down to the question as to whether the iron properties should be taxed to a still greater extent and differently from other property, because as the proponent of the proposed tax says, 'The body of iron ores is diminishing and nothing will eventually be left but holes in the ground.'

Unsound and Illegal.

Those who live in the communities affected to the greatest extent by the removal of this property are practically unanimous against the proposed law. Some of those who live in other sections of the state and who would be the least affected by the disappearance of the ore, advocate the taxing of the Northeastern section of Minnesota on a different basis from other portions of the state. Any theory which holds that certain properties by being removed diminishes in value the land from which it is taken, therefore being taxed at a higher

rate than other properties, is unsound and illogical. The fact that most of the iron ore is taken out of the state is no more of an argument for increasing the taxes thereon than the removal from the state of lumber, granite, grain or any other property would be the ground for increasing the taxes on the last named commodities. The iron ore is being converted continually into taxable subjects, such as buildings, machinery, and other instrumentalities upon which taxes must be paid. It is true that all of these taxes that are imposed are not paid in Minnesota but that is no reason for taxing iron ore in a different way from that applied to other Minnesota products which are removed from the state and converted into different forms of property elsewhere.

Opposed Confiscation by Taxation.

It is also contended that the iron ore intended to be taxed by the measure now under discussion is the product of Nature and formerly property of the state of Minnesota, and for that reason should be taxed on a different basis than other property. The fact is that iron ore is not the product of Nature to any greater extent than the soil, and that the state originally owned none of this property but did acquire a small portion thereof by grant from the Federal government. If any individual or corporation has procured from the state a title to iron land illegitimately, it should resort to the courts and not to the legislature for relief. If, however, the land has been honestly acquired by the owners thereof, the state has no right to attempt to take it by legislation under the guise of taxation.

* * * * * *

Very respectfully yours,

J. A. A. BURNQUIST,
Governor."

2. *Act Proposing Constitutional Amendment Afterwards Adopted, Authorizing an Occupation Tax and Placing a Part of the Proceeds Thereof Aside for Future Generations.*

(Being Chapter 529, H. F. 761, Session Laws of Minnesota, 1921.)

"An Act proposing an amendment to Section 1 of Article 9 of the Constitution of the State of Minnesota by adding thereto a new section imposing a tax upon per-

sons, co-partnerships, companies, joint stock companies, corporations, and associations however or for whatever purpose organized, engaged in the business of mining or producing iron ore or other ores and providing for the distribution of such taxes.

Be it enacted by the Legislature of the State of Minnesota:

Section 1. That the following amendment to section 1 of article 9 of the constitution of the State of Minnesota is hereby proposed to the people of the State of Minnesota for their approval or rejection, that is to say: Section 1 of Article 9 of the constitution shall be amended by adding thereto a new section to be known as section 1A, which new section shall read as follows, to-wit: Section 1A. Every person, co-partnership, company, joint stock company, corporation, or association however or for whatever purpose organized, engaged in the business of mining or producing iron ore or other ores in this state, shall pay to the State of Minnesota an occupation tax on the valuation of all ores mined or produced, which tax shall be in addition to all other taxes provided by law, said tax to be due and payable from such person, co-partnership, company, joint stock company, corporation, or association however or for whatever purpose organized, on May first of the calendar year next following the mining or producing thereof. The valuation of ore for the purpose of determining the amount of tax to be paid shall be ascertained in the manner and method provided by law. Funds derived from the tax herein provided for shall be apportioned; fifty percent to the State General Revenue Fund, forty percent to the Permanent School Fund and ten percent to the Permanent University Fund. The Legislature shall by law make the necessary provisions for carrying out the provisions of this section."

(Sections 2 and 3 have reference to the manner of submitting the proposed amendment to the people for adoption.)

3. *The Occupation Tax.*

This Act has been so recently before the court that it is not repeated here. See *Oliver Iron Mining Co.* v. *Lord*, 262 U. S. 172.

4. *Extracts from Inaugural Message of Governor Preus to the Legislature of Minnesota January 5, 1921.*

"Tonnage Tax.

* * * * * *

Argument is made that iron ore is a gift of Nature, a natural heritage of the state, a natural resource that is diminished by continued mining, leaving waste land in its wake, that it should therefore take a classification different from other forms of property which are the result of toil and that it should bear a heavier tax than other property in order to meet the depletion and disappearance of such natural wealth.

* * * * * *

* * * While I reiterate that I do not desire to confuse the mind and befog the eye by proposing legislation which would complicate tonnage tax legislation, nevertheless, if a higher tax on such property is justifiable on the ground that the people of the state have a heritage in the iron ore deposits to be found within its borders, then it would seem that at least a part of the proceeds should be regarded as a trust fund and not merely a heritage to those who happen to be living while the iron ore is being taken out of the ground. If it is a heritage, it is a heritage of future as well as present generations."

5. *Extract from Chapter 5 of the Seventh Biennial Report of the Minnesota Tax Commission.*

"Arguments For and Against a Super-tax.

The principal arguments used by the proponents of a super-tax on iron ore may be summarized as follows:

Iron ore being a product of nature, its presence in the ground not being the result of the expenditure of capital or labor, is a natural heritage of all the people, and as such, the people are justified in appropriating to their use, in some form of taxation, some considerable part of the value arising from its exploitation.

That it does not reproduce itself, therefore its value is diminished by use through depletion, and that because of this diminishing value it should bear a heavier tax than other forms of natural property not diminished by use.

That under existing conditions the bulk of this great natural heritage is gradually being removed from the state to enrich other states, and that eventually its value as a taxable state asset will have disappeared through depletion due to shipments, and in its place will be found only valueless 'holes in the ground,' and that for this reason the state is justified in exacting a heavy toll in the form of a super-tax for the depletion and disappearance of its natural wealth.

That a super-tax on profits will insure the state a fairly uniform amount of public revenue annually from mine taxation during the life of mining in the state, while, if it depends on ad valorem taxes only, the receipts therefrom will soon begin to decline, and will reach the vanishing point within a generation.

In answer to these arguments the opponents of a super-tax contend:

That the natural heritage theory has no greater force in its application to iron ore than to other forms of natural wealth.

That if the state has a natural heritage in iron ore, it also has a natural heritage in its quarries, its forests, and its fertile agricultural lands.

That if one form of natural wealth should bear a super-tax because of the heritage theory, then all forms of natural wealth should be subjected to the same tax.

That admitting for the purpose of the point that the heritage argument has some force, it is a heritage of the nation, and not simply a heritage of the people of Minnesota, for the people of this state had no more to do with the placing of iron ore in the ground than had the people of other states.

In answer to the diminishing value argument and the disappearance from the state of its natural wealth the opponents of the supertax contend:

That a part of the ore is converted into other forms of wealth in this state and continues to be a taxable asset of the state.

That the mining of the ore creates other forms of taxable wealth that would not be called into being if we had no ore deposits.

That while at the present time a large part of the ore is shipped out of the state, a considerable part of

it comes back again in manufactured form, and thus again becomes a taxable asset of the state.

That if our natural wealth should be subjected to a heavy supertax because a part of it is being shipped out of the state, then other states would be justified in imposing an equally heavy supertax on coal and other natural commodities shipped into this state, thus adding to their cost; that such a theory is wholly selfish and economically unsound.

That any substantial increase in the present tax burden on mines will tend to discourage the mining industry and to stop explorations for new tonnages, as well as to discourage, if not eventually stop the experiments that are now being carried on at great private cost to render commercially valuable the immense deposits of low grade and magnetic ores known to exist within the state, and that excessive taxation in any form will force mining people to discontinue or greatly curtail their activities, and to direct their attention to the ore deposits of other states or countries in which the mining industry is not burdened with excessive taxes."